Pendal Monthly Commentary

Pendal Sustainable Future Australian Shares Portfolio

September 2023

Market commentary

Continued resilience in the US economy has pushed out the timeline for expected rate cuts and saw expectations around the ultimate terminal rate creep up.

In combination with larger US bond supply, this pushed US ten-year bond yields up materially, weighing on equity markets in the US and around the world.

The dominant narrative of resilient global economic momentum and higher-for-longer rates continues.

The S&P 500 fell -4.9% for the month. The S&P/ASX 300 proved more resilient, helped by index composition with a greater exposure to financials and commodities, which held up relatively well. It ended down -2.89% for September.

The Energy sector (+2.23%) was the only one to rise. Higher oil prices helped Woodside Energy (WDS, -1.43%) and Santos (STO, +3.00%) outperform, while Whitehaven (WHC, +16.75%) and New Hope (NHC, +12.79%) benefited from increased coal prices.

Financials (-1.61%) generally benefit from higher rates and held up better than the broader market. National Australia Bank (NAB, +0.38%) and ANZ (ANZ, +1.30%) were the best of the large banks, while insurer QBE (QBE, +4.89%) also did well.

Real Estate (-8.54%) underperformed on broad-based weakness. The recent reporting season demonstrated the effect that higher rates was having on interest expense and earnings. Goodman Group (GMG) fell -8.18% and Scentre Group (SCG) -10.55%.

The prospect of higher-for-longer rates also weighed on Information Technology (-7.74%). Again, weakness was broad-based with the sector's largest stocks Xero (XRO, -10.13%), Wisetech (WTC, -6.29%) and NextDC (NXT, -8.49%) all down.

Portfolio overview

Sustainable Future Australian Shares Portfolio	
Investment strategy	Pendal's investment process for Australian shares is based on its core investment style and aims to add value through active stock selection and fundamental company research. Pendal's core investment style is to select stocks based on its assessment of their long term worth and ability to outperform the market, without being restricted by a growth or value bias. Pendal's fundamental company research focuses on valuation, franchise, management quality and risk factors (both financial and non-financial risk)
Investment objectives	To deliver outperformance relative to the benchmark before fees over a rolling five year period by investing in companies which Pendal has identified as having leading financial, ethical and sustainability characteristics.
Benchmark	S&P/ASX 300 (TR) Index
Number of stocks	15 - 40 (29 as at 30 September 2023)
Sector limits	Australian Shares, 65 - 98%, Australian Property 0 - 30%, Cash 2 - 5%
Dividend Yield	3.70%#

Top 10 holdings

Code	Name	Weight
CSL	CSL Limited	9.50%
CBA	Commonwealth Bank of Australia	7.06%
TLS	Telstra Group Limited	6.41%
NAB	National Australia Bank Limited	5.94%
QBE	QBE Insurance Group Limited	5.73%
RIO	Rio Tinto Limited	5.48%
GMG	Goodman Group	4.04%
WBC	Westpac Banking Corporation	3.93%
QAN	Qantas Airways Limited	3.80%
MQG	Macquarie Group, Ltd.	3.76%

Source: Pendal as at 30 September 2023

Top 5 overweights versus S&P/ASX 300

Code	Name	Weight
QBE	QBE Insurance Group Limited	4.64%
TLS	Telstra Group Limited	4.34%
CSL	CSL Limited	3.88%
RIO	Rio Tinto Limited	3.52%
QAN	Qantas Airways Limited	3.38%

Top 5 underweights versus S&P/ASX 300

Code	Name	Weight
BHP	BHP Group Ltd (not held)	-10.42%
WDS	Woodside Energy Group Ltd (not held)	-3.22%
WES	Wesfarmers Limited (not held)	-2.79%
WOW	Woolworths Group Ltd (not held)	-2.11%
TCL	Transurban Group Ltd. (not held)	-1.82%

Source: Pendal as at 30 September 2023

#The Portfolio's dividend yield represents the weighted average 12-month forward-looking dividend yield of the portfolio holdings (excluding cash), as at the date of the Factsheet. Each individual security's dividend yield is calculated using market consensus Dividend Per Share (DPS) before tax and franking credits, collated by Pendal and divided by the closing market price of the security as at the date of the Factsheet. The portfolio dividend yield therefore is only an estimate, and does not reflect the actual returns of the Fund, which will be affected by market movements in the price of individual securities, the returns on other assets such as cash holdings and variances of individual security's actual dividends from the forecasted DPS.

Performance

	1 month	3 month	6 month	1 year	3 year (p.a.)	5 year (p.a.)	Since inception (p.a.)*
Pendal Sustainable Future Australian Shares Portfolio	-4.56%	-2.63%	-0.20%	11.80%	9.79%	7.69%	7.79%
S&P/ASX 300 (TR) Index	-2.89%	-0.84%	0.14%	12.92%	10.78%	6.62%	6.90%
Active return	**-1.67%**	**-1.79%**	**-0.34%**	**-1.12%**	**-0.99%**	**1.07%**	**0.89%**

Source: Pendal as at 30 September 2023
*Since Inception - 16 June 2018
Performance returns are pre-fee. Investors should contact their platform provider for applicable fee rates.
Past performance is not a reliable indicator of future performance.

Top 5 contributors - monthly

Code	Name	Value Added
QBE	QBE Insurance Group Limited	0.33%
CGC	Costa Group Holdings Ltd.	0.16%
RIO	Rio Tinto Limited	0.11%
NEC	Nine Entertainment Co. Holdings Limited	0.10%
SUN	Suncorp Group Limited	0.09%

Top 5 detractors - monthly

Code	Name	Value Added
BHP	*BHP Group Ltd (not held)*	*-0.44%*
ORA	Orora Ltd.	-0.41%
QAN	Qantas Airways Limited	-0.35%
JHX	James Hardie Industries PLC	-0.24%
AKE	Allkem Limited	-0.21%

Top 5 contributors - 1 year

Code	Name	Value Added
QBE	QBE Insurance Group Limited	1.04%
XRO	Xero Limited	0.76%
PLS	Pilbara Minerals Limited	0.43%
FMG	Fortescue Metals Group Ltd	0.39%
NXT	Nextdc Limited	0.38%

Top 5 detractors - 1 year

Code	Name	Value Added
CSL	CSL Limited	-1.02%
BHP	*BHP Group Ltd (not held)*	*-0.87%*
DOW	Downer EDI Limited	-0.67%
ORA	Orora Ltd.	-0.48%
AKE	Allkem Limited	-0.46%

Source: Pendal as at 30 September 2023.
Underweight positions are in italics.

Stock specific drivers of monthly performance relative to benchmark

Three largest contributors

Overweight QBE Insurance (QBE, +4.87%)

There was little material stock-specific news for QBE Insurance, however it is likely to have benefited from a strengthened higher-rates-for-longer thematic in the market. We continue to like QBE due to a supportive pricing cycle, in which premium growth is more than offsetting claims inflation. At the same time the company continues to execute on a turnaround, divesting and running-off troubled businesses.

Overweight Costa Group (CGC, +9.82%)

Costa Group's board recommended shareholders accept the $3.20 per share bid from private equity firm Paine Schwartz. The stock had fallen following a disappointing result and the expectation that the takeover bid may be revised down from $3.50 per share, as it subsequently was. However news of an agreed deal saw it rebound in September.

Overweight Rio Tinto (RIO, +0.58%)

Resilience in iron ore prices helped support Rio Tinto in September. While the Chinese property sector remains weak, broader steel production has held up well and is one of the few pockets of strength in the Chinese economy. There is also persistent hope that ongoing weakness will prompt Beijing to do more on the stimulus front.

Three largest detractors

Underweight BHP (BHP, +1.49%)

The iron ore prices continue to hold up well despite ongoing weakness in the Chinese property sector, helping support BHP. Steel production remains one of the few bright spots in the Chinese economy, with expected quota-driven curtailments not yet materialising. There is also the ongoing hope in some quarters of further stimulus to help put a floor under economic growth. BHP is excluded from the portfolio due to its coal exposure. There was some offset to this from the exposure to Rio Tinto.

Overweight Orora (ORA, -14.51%)

Orora announced an equity capital raising to fund the acquisition of global luxury/premium bottling business Saverglass. The market expressed concern that this fell outside ORA's core area of expertise. However while there are risks, we see merit in the deal and valuation upside for the combined entity.

Overweight Qantas (QAN, -12.35%)

QAN endured a month of negative headlines and CEO Alan Joyce brought forward his retirement by two months. The company has committed to restoring its damaged brand, announcing a further $80m investment to support customer experience in FY24, on top of the $150m already budgeted for this area at the FY23 result. The board have also made changes to management remuneration with an increased weighting to customer metrics and greater scope for discretion around long-term incentives. While there is a lot of work for QAN to do to restore their reputation, the key issue is whether profits will be structurally impacted via flight slots being reallocated, demand affected or costs rising. The stock is trading at 25-30% below pre-pandemic value, with profits 60% higher. In our view, we see this as a large buffer of value.

Performance and outlook

Equity markets sit at an interesting juncture after falling over the last month.

The bullish perspective is this is a period of consolidation at a seasonally weak time of year. From here, this could see US inflation and wage growth continue to slow while the economy holds up, which may mean no recession. In this case, interest rates may have peaked despite Fed rhetoric, implying that earnings are set to grow and valuation ratings rise, lifting markets higher.

The alternative, bearish case is that bond yields, the US dollar and the oil price have all been moving higher, which have historically been warning signals for the market. Higher oil prices means that inflation in the US, while softening, may not fall as fast as the market wants. There is also risk that the delayed effects of monetary tightening will lead to the economy slowing more materially than expected, putting pressure on earnings.

Australian GDP grew 0.4% in the June quarter and 2.1% year-on-year. While in line with expectations, it highlighted some challenges for the economy.

GDP per capita fell 0.3% for the quarter given strong population growth. When it comes to company earnings aggregate spending is what counts.

Breaking down the data, quarterly growth in household consumption was weak at 0.1% quarter-on-quarter. Savings rates have fallen to 3.1% which is a cycle low.

There is growth coming from business investment, which is up 5.6% year-on-year in mining and 9.1% in non-mining sectors. Government spending remains strong at 1.8% growth quarter-on-quarter and exports grew 4.3%, helped by mining.

Employee compensation growth is strong at 1.6% quarter-on-quarter and 9.6% year-on-year. Households continue to find ways to supplement income.

Nevertheless Australia is an economy with slowing growth, reliant on government spending, business investment and commodity exports. All of which are either unsustainable or volatile and potentially leaves us vulnerable to an inflation surprise and/or a growth problem if the current environment shifts.

At the same time productivity is very weak, which may lead to profits coming under pressure, higher unemployment or more price inflation as companies pass costs on.

There have been some positive signs on China. While we have not seen a large-scale stimulus packages, there have been a slew of more targeted measures to help underpin the economy. The latest PMI activity indices may suggest the worst of activity data could now be behind us. Nevertheless the property market remains weak, although the iron ore price has remained surprisingly resilient.

In this environment we see stock selection as critical. The range of macro pathways and outcomes remains wide, in our view this means it is important to try and balance thematic risks in the portfolio. Instead we are looking for companies which offer different types of macro exposures, in combination with a company-specific opportunity for earnings growth or valuation re-rating.

In this vein, rolling twelve-month sector dispersion has fallen materially versus stock dispersion for the S&P/ASX 300 over the course of 2023, after rising for most of the previous year. This suggests an improved environment for stock picking, which we believe plays to the strengths of our team.

New stocks added and/or stocks sold to zero during the month

No new stocks added or sold to zero during the month.

Carbon performance

The estimated weighted average carbon intensity (WACI) of the portfolio, using greenhouse gas emissions (scope 1 and 2[1]) data supplied by ISS and weighted by the size of our holding in each company, is shown in the table below. In other words, this provides an indication of a portfolio's exposure to carbon intensive companies. We also compare this to the weighted average emissions for the companies in the aggregated ASX300 index.

We caution that there are limitations of using carbon metrics as an indicator of a portfolio's overall exposure to climate-related risks. For example, not all companies report their emissions data and hence some of the below analysis includes estimates. Also, it does not include scope 3 emissions. Further, portfolio carbon analysis does not capture exposure to physical climate-related risks, or the unique transition risks some companies within the portfolio face. Nevertheless, the WACI metric is recommended by the Task Force on Climate-related Financial Disclosures (TCFD)[2], noting it supports greater comparability of investor reporting.

Weighted Average Carbon Intensity (tonnes CO_2e / \$M revenue)

Pendal Sustainable Future Australian Share Portfolio	ASX 300	Relative to ASX300
124.15	166.66	-42.51

Source: ISS, Pendal holdings as at 30 September 2023. Report run on 06/10/2023 using latest ISS data. Currency AUD

[1] Scope 1 emissions result from sources directly owned or controlled by the company. Scope 2 accounts for emissions from the generation of purchased electricity consumed by the company. Scope 3 emissions result from activities not directly owned or controlled by the company but are associated with its operation such as business travel, waste management, commuting, and the use of sold products and services. https://ghgprotocol.org/sites/default/files/standards/ghg-protocol-revised.pdf

[2] *Recommendations of the Task Force on Climate-Related Financial Disclosures, June 2017* https://www.fsb-tcfd.org/recommendations/

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